COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF NOLIN RURAL ELECTRIC COOPERATIVE CORPORATION FOR A DEVIATION FROM THE PSC STAFF'S POSITION THAT NOLIN CANNOT OFFSET LOSSES AGAINST MARGINS IN DETERMINING A PAYOUT OF CAPITAL CREDITS AND THE DEVIATION FROM THE SETTLEMENT AGREEMENT OF OCTOBER 11, 1990 IN CASE NO. 90-064	)	CASE NO. 97-502

O R D E R

IT IS ORDERED that Nolin Rural Electric Cooperative Corporation ("Nolin") shall file an original and 10 copies of the following information with this Commission, with a copy to all parties of record. Each copy of the data requested should be placed in a bound volume with each item tabbed. When a number of sheets are required for an item, each sheet should be appropriately indexed, for example, Item 1(a), Sheet 2 of 6. Include with each response the name of the witness who will be responsible for responding to questions relating to the information provided. Careful attention should be given to copied material to ensure that it is legible. The information requested herein is due no later than 21 days after the date of this Order.

1. Provide a schedule showing separately the amounts actually paid as general capital credit retirements and capital credits to deceased members' estates for the calendar years 1994, 1995, 1996, and 1997.

2. For each period listed below, show the calculations of the minimum capital credit refund. Include all schedules and work papers necessary to support these

calculations. These calculations shall reflect the exclusion of all costs that the Commission historically has disallowed for rate-making purposes. Such costs include medical insurance for the members of the cooperative's board of directors, Kentucky WIRE scholarships, new member surveys, flowers for employees or directors, donations, framing of documents, portraits of the members of the board of directors, and employee Christmas parties.

a. Calendar year 1994 operations, to be paid in 1995.

b. Calendar year 1995 operations, to be paid in 1996.

c. Calendar year 1996 operations, to be paid in 1997.

d. Calendar year 1997 operations, to be paid in 1998, if available.

3. Nolin signed settlement agreements with the Commission Staff in Case Nos. 90-064[1] and 94-402.[2] In both cases, the Commission approved the settlement agreements without change. Does Nolin agree that both settlement agreements provide that:

a. All total margins in excess of a 1.5 Times Interest Earned Ratio ("TIER") will be used by Nolin to rotate capital credits to its members?

b. For purposes of determining Nolin's earnings and margins, reference will be made to Nolin's Annual Report on file with the Commission?

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1 Case No. 90-064, The Application of Nolin Rural Electric Cooperative Corporation of Elizabethtown, Kentucky for an Order Authorizing an Adjustment in Its Retail Rates Applicable to All Consumers, final Order dated October 31, 1990.

2 Case No. 94-402, Application of Nolin Rural Electric Cooperative Corporation Concerning Existing Rates, final Order dated August 7, 1995.

c. Nolin's Annual Reports will be adjusted to eliminate any cost that is not normally allowed by the Commission for rate-making purposes?

d. Nolin may apply to the Commission for relief from its obligations to retire capital credits when, due to circumstances beyond Nolin's control, the Rural Electrification Administration ("REA"), now the Rural Utilities Service ("RUS"), and the National Rural Utilities Cooperative Finance Corporation ("CFC") have suspended or discontinued advancing loan funds to Nolin?

4. Nolin states in its application that it did not make a general retirement in 1996 of capital credits for the reason that the margins earned in 1995 which would normally have been used to retire capital credits in 1996 were offset by the 1994 negative margins which resulted in a net loss, thus requiring no retirement of capital.

a. Would Nolin agree that the amount identified as the 1994 calendar year negative margin, which Nolin has used to offset capital credit rotations required from 1995 and 1996 operations, is the difference between the Commission adjusted margins for 1994 operations and the margins needed to produce a TIER of 1.5? If not, explain what the 1994 negative margin reflects.

b. Cite the specific provision of either settlement agreement which allows Nolin to offset the amount of total margins <u>in excess</u> of 1.5 TIER for one calendar year by the amount of total margins <u>needed to achieve</u> a 1.5 TIER in a previous calendar year.

5. When Nolin determines its net margins on its annual income statement, does it adjust the net margins earned for the calendar year by any previous calendar

years' negative margins? If yes, provide copies of appropriate income statements from Nolin's Annual Report filed with the Commission which show this treatment.

6. Describe the procedures used by Nolin to:

a. Allocate net margins to its patronage capital accounts.

b. Allocate negative margins to its patronage capital accounts.

7. Provide copies of Nolin's bylaws which address the subject of patronage capital in connection with furnishing electric energy or electric service. The copies should reflect the bylaw provisions in effect as of October 31, 1990, with any amendments or revisions clearly identified and the date of any change noted.

8. In its application, Nolin repeatedly focuses on the provisions of the October 11, 1990 Settlement Agreement ("1990 Agreement") from Case No. 90-064. However, that agreement was superseded and replaced by the July 6, 1995 Settlement Agreement ("1995 Agreement") from Case No. 94-402.

a. Why has Nolin focused its application in this case on the 1990 Agreement, which has been superseded?

b. Explain how the Commission can consider granting a deviation from the 1990 Agreement, when that agreement was superseded by the 1995 Agreement?

9. The 1995 Settlement Agreement requires Nolin to make payment of capital credits to its members within 120 days of the close of the calendar year in which its total margins exceed a 1.5 TIER. It further requires that any request for relief from the requirement to rotate capital credits be sought within 60 days of the close of that calendar year.

a. In view of Nolin's failure to request relief within 60 days of the close of calendar year 1996, why should the Commission not consider Nolin's application for deviation as untimely filed and dismiss it?

b. In light of Nolin's failure to comply with the time limits for making the required capital credit rotation for calendar year 1996 or requesting relief from the provisions of the 1995 Settlement Agreement, why should the Commission not consider Nolin in violation of its Order of August 7, 1995 in Case No. 94-402?

10. a. Has RUS suspended or discontinued advancing loan funds to Nolin? If yes, provide all correspondence, memoranda, and other documents that Nolin has received from RUS regarding such suspension or discontinuance.

b. Has CFC suspended or discontinued advancing loan funds to Nolin? If yes, provide all correspondence, memoranda, and other documents that Nolin has received from RUS regarding such suspension or discontinuance.

11. Attached to this Order as Appendix A are a series of quotes from REA Bulletin 102-1. Nolin contends that this document supports its claim that the amount needed to achieve a 1.5 TIER from 1994 operations can be used as an offset to its obligation to rotate capital credits based on the results of 1995 and 1996 operations. Explain how Nolin reached this conclusion, given that the referenced sections from REA Bulletin 102-1 contained in Appendix A of this Order clearly state that only non-operating margins can be used to offset and eliminate operating deficits of prior years.

12. In its application, Nolin states that it is on a 12-year rotation cycle for its capital credits. In its application in Case No. 94-357,[3] Nolin stated that it was on a nine-year capital credit rotation cycle. The 1995 Agreement states that until Nolin develops and presents a new equity management plan to the Commission for its review and approval, the equity management plan enacted to comply with the terms of the 1990 Agreement shall be followed.

a. Has Nolin amended or modified the equity management plan that was enacted to comply with the terms of the 1990 Agreement?

b. If yes to part (a):

(1) Describe each amendment or modification Nolin has made to the equity management plan and the date the amendment or modification became effective.

(2) Indicate when Nolin submitted each amendment or modification to the Commission for its review and approval. If no submissions were made, explain why Nolin did not notify the Commission of these changes.

c. Indicate the capital credit rotation cycle incorporated in the equity management plan that was enacted to comply with the 1990 Agreement.

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3 Case No. 94-357, The Application of Nolin Rural Electric Cooperative Corporation for a Deviation from the Settlement Agreement of 10/11/90 in Case No. 90-064. The nine-year capital credit rotation cycle is referenced on page 3 of the March 13, 1995 Order.

d. Indicate when Nolin adopted a 12-year capital credit rotation cycle and explain how Nolin determined that a 12-year cycle was the most appropriate and reasonable.

13. In its application, Nolin has requested that it be granted a deviation to defer the 1997 payment of capital credits until such time as its board of directors and management determines that Nolin is fiscally responsible to pay such credits. Define "fiscally responsible" as it is used in Nolin's application.

14. On two previous occasions, Nolin has requested indefinite deferral of its obligation to pay capital credits, and the Commission has denied the requests.[4] In both instances, the Commission identified several problems with Nolin's proposal. Since Nolin has again proposed an indefinite deferral of its obligation to pay capital credits:

a. Describe the steps Nolin has taken to address the problems the Commission has previously identified concerning the indefinite deferral of required capital credit payments.

b. Describe the circumstances which are different in this case as compared with previous requests for indefinite deferral.

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[4] Case No. 90-064, December 20, 1991 Order, at 3 and Ordering Paragraph No. 1 and Case No. 94-357, March 13, 1995 Order, at 4 and Ordering Paragraph No. 1.

Done at Frankfort, Kentucky, this 20th day of March, 1998.

PUBLIC SERVICE COMMISSION

B. J. Helton

For the Commission

ATTEST:

Helen C. Helton

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 97-502 DATED MARCH 20, 1998

SELECTED SECTIONS OF REA BULLETIN 102-1

REA Bulletin 102-1, Section III - Policy and Recommendations.

A. REA recommends that each cooperative borrower operate under capital credit bylaws whereby all amounts received in excess of losses, costs and expenses will be included in the patrons' capital credit accounts. The bylaws should clearly establish an agreement between the cooperative and its members and patrons that:

1. amounts paid in excess of costs and expenses of providing service are furnished as capital;
2. such amounts will be determined annually on a patronage basis and credited to a capital account for each patron;
3. all other amounts received by the cooperative from its operations in excess of costs and expenses will be (a) used to offset any losses incurred during the current or any prior fiscal year and (b) to the extent not needed for that purpose, allocated on a patronage basis and included as a part of the capital credited to the accounts of patrons;
4. each patron will be notified annually of the amounts credited to his capital account; and
5. capital credited to patrons will be returned to them on a revolving basis when the board determines that the financial condition of the cooperative will not be impaired thereby.

March 5, 1964 Memo to Boards of Directors of Electric and Telephone Cooperatives, Paragraphs 7 and 8, Attachment to REA Bulletin 102-1.

The revised bylaw provides that the so-called non-operating margins not needed for offsetting deficits will be included with the amounts furnished as capital and allocated to the patrons. The allocation of non-operating margins in this manner increases the patrons' capital credits, reduces their cost of service, and clearly establishes the interest of each patron in the cooperative's net worth.

The offsetting of deficits or losses against non-operating margins is recommended in order to avoid the carrying of deficits indefinitely on a cooperative's books. Up to this time any deficits incurred, usually during the early years of operation, have remained on the books as a separate item notwithstanding the accumulation of net worth in later years. The revised bulletin now provides an orderly method for offsetting deficits. These offsets will not affect the cash position or change the net worth of the cooperative.

REA Bulletin 102-1, Appendix A, page 3 - Deficits and Non-Operating Margins.

Under capital credits, amounts paid by patrons in excess of costs and expenses of providing service are paid in as capital and are credited to the capital accounts of the patrons. Patrons' capital accounts are credited with the amounts of capital paid in each year even though deficits have been incurred during past years. The bulletin (paragraph III A 3) recommends that all other amounts received by the cooperative from its operations in excess of costs and expenses, usually referred to as "non-operating margins," be allocated to patrons on a patronage basis to the extent that such non-operating margins are not needed to offset any losses incurred during the current or prior years.
Before any allocations of non-operating margins are made, losses should be deducted from these margins. This will enable the cooperative to (a) offset deficits in an orderly manner, and (b) account on a patronage basis to its patrons for all amounts received from its operations in excess of costs and expenses. This means that any deficits will be systematically offset by non-operating margins and the patrons will always be credited with the capital they furnish the cooperative together with other allocable amounts. This furthers the objective of providing patrons with maximum benefits from the overall operation of the cooperative.

REA Bulletin 102-1, Appendix B, page 2, Section III - Eliminating Deficits of Power Supply Cooperatives.

A. The bylaw provision set forth in Appendix A permits only the use of nonoperating margins to offset and eliminate operating deficits of prior years.